2. The Patel Affidavit is entirely unilluminating and contains serious analytical flaws.

a) The Patel Affidavit is devoid of factual support or informed analysis.

The Applicants' sole effort to support their anticipated cost savings consists of an affidavit filed by WorldCom's treasurer, Sunit Patel. Remarkably, the only numbers in this document are at the bottom of each page; the affidavit contains not a single dollar sign, equation, calculation, algorithm, projection, table, or spreadsheet. Rather, the affiant simply states that "[t]he cost savings estimates were prepared jointly by a team of WorldCom and MCI engineers and analysts"; that "WorldCom believes that [these estimates] are, on the whole, achievable"; and that "it would be impossible in this affidavit to replicate" all of the work that went into the preparation of the estimates.[169] Following these assurances, the affidavit identifies three broad areas where cost savings may be realized and recites hedged statement after hedged statement regarding events that concededly may or may not occur.

Had the Applicants provided the numbers, projections, and assumptions that were used to derive the $ 23 billion figure, or disclosed the analysis team's work papers, the Commission and interested parties might have been able to determine whether the claimed savings are both achievable and likely to translate into consumer benefits. They did not do so, however, making it impossible to perform the balancing between costs and benefits required under *Bell Atlantic/NYNEX*. Moreover, there is

[169] Patel Affidavit at 1, 2.

every reason to believe, first, that the claimed cost savings are terrifically exaggerated, and second, that those "savings" that do exist actually flow in large part from increased profits due to diminished competition.

b) The Patel Affidavit Ignores Substantial Costs of the Merger and Practical Constraints on Recognizing Substantial Savings in Key Areas.

To hear the Applicants tell it, the merger will be all gain and no pain: everywhere one looks, savings are ripe for the picking, and there are no appreciable offsetting costs. For example, the Applicants represent that they will achieve significant cost savings by integrating their networks[170] and by combining traffic.[171] However, they fail to quantify or even acknowledge the existence of the potentially substantial expenditures, investments, and opportunity costs that must be incurred in order to realize the anticipated cost savings. Similarly, they ignore tremendous practical obstacles to achieving access charge reductions and other claimed efficiencies. As detailed in GTE's March 13 Comments and further discussed below and in the attached Harris Reply Affidavit, these critical flaws undermine any limited credibility that the Applicants' claimed savings otherwise might have.

WorldCom and MCI have ignored the difficulty and costs of integrating disparate networks. WorldCom and MCI would have the Commission believe that network integration is a simple task. However, this process is hardly as effortless as the

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[170] *See id.* at 2.

[171] Patel Affidavit at 3-12.

Applicants contend. The significant costs and difficulties associated with combining disparate switches, network management systems, and operations support systems ("OSS") should not be minimized. Indeed, analysts have expressly concluded that the "long-term success of the MCI/WorldCom merger hinges in large part on the new company's ability to meet its cost savings numbers, and achieving that goal depends greatly on its ability to integrate networks and operations successfully."[172]

Although any definitive analysis is precluded by the Applicants' failure to provide even the most basic information regarding their integration plans, there is good reason to believe that WorldCom and MCI will have an exceptionally difficult time combining their disparate networks, and that such integration, even if possible, will come only at great cost. As Dr. Harris explains in his Long Distance Reply Affidavit, "the costs associated with integrating separate long-distance and Internet networks with different hardware and software systems should not be ignored or underestimated"[173]:

> For example, the firms have separate billing systems, whose consolidation will "take years" to complete, according to Paul Wickre, President of Frame Relay Systems and Technology, Inc. In addition, MCI and WorldCom use different routing equipment for frame relay service .... Eliminating these dual systems without disruption in service levels will pose serious difficulties.[174]

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[172] Dawn Bushaus, "Fit to Be Tried" (last modified Feb. 25, 1998), <http://www.teledotcom.com/0398/features/tdc 0398worldcom.html> ("Bushaus").

[173] Harris LD Reply Affidavit at 48.

[174] *Id.* (footnotes omitted)

The obstacles to and costs of integration are at least as great on the Internet side. WorldCom already faces a huge challenge integrating ANS, Compuserve Network Services, and GridNet International; currently, it is running these three networks and UUNet separately and "will not even begin the process of physically integrating its different Internet subsidiaries' networks until the end of 1998."[175] Each of these networks uses equipment from a different vendor. Adding MCI's backbone to the mix will only complicate the task:

> According to a *Network World* interview with WorldCom COO and UUNet CEO John Sidgmore, after the merger between MCI and WorldCom, the two companies Internet backbones will not be able to achieve cost savings by reducing their combined number of POPs. The two networks will be "more robustly interconnect[ed]" but "we will probably not take out any hubs or [points of presence.]"[176]

In short, there are serious questions whether the Applicants have the technical expertise and capabilities "to realize all of their synergy goals, especially regarding OSS integration."[177] Staffers have indicated that "their firsthand experience with past merger and reengineering efforts at MCI and WorldCom suggest that integration may not be as smooth and fast as the two companies suggest it will be."[178] Even John Sidgmore, WorldCom's Chief Operating Officer, "admits [that] he's worried that WorldCom may be

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175 *Id.* at 49.

176 *Id.* at 50, *citing* "WorldCom's Sidgmore sizes up the deal," *Network World*, Nov. 17, 1997, available at <http://www.nwfusion.com/news/1117sidgmore.html>.

177 Bushaus.

178 *Id.*

moving too fast."[179] Sidgmore explains: "You're merging thousands and thousands of employees, multiple infrastructures, multiple operating systems, multiple billing systems, and different cultures. There's a lot of risk."[180] When the Applicants themselves acknowledge that there is significant risk associated with consolidation, the Commission is obligated to scrutinize the merged entity's ability to meet their projected cost savings.

The Applicants have ignored the opportunity costs of self-provisioning access and transport and have greatly exaggerated potential cost savings from more efficient trunking and routing. The Applicants contend that tremendous cost savings will result from providing access and transport to each other as part of a single entity rather than through their existing vendor-customer relationship.[181] They also claim that the merged company will experience reductions in both fixed and variable domestic network costs due to more efficient trunking and routing of traffic over combined facilities.[182] In both cases, however, WorldCom and MCI vastly overstate the potential savings.

With respect to the purported savings from self-provisioning access and transport, the Applicants fail to account for offsetting opportunity costs. As Dr. Harris explains in his Reply Affidavit, "[i]n effect, the merger simply replaces an inter-firm hard payment for an intra-firm transfer price; MCI-WorldCom claims the hard cost reduction

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[179] *Id.*

[180] *Id.*

[181] *See* Patel Affidavit at 3-12.

[182] *See id.* (citing savings in offnet costs, DAL/LL costs, entrance facilities costs, switched access costs, WATS costs, directory assistance costs; debit card costs).

is a synergy without considering the effects of the hard revenue reduction."[183] However, "the only economically relevant effect of the merger on the combined companies' profitability is the potential reduction in transaction costs associated from procuring the ... link from MCI the affiliate as opposed to MCI the third party and from any expansion in WorldCom's consumption of MCI circuits in response to price reductions by MCI." As Dr. Harris concludes, "[t]his amount is much smaller than the total cost reduction mentioned by Mr. Patel."[184]

In addition, as Dr. Harris has previously shown, the Applicants' estimate of savings resulting from more efficient trunking arrangements is overstated. In his affidavit, Dr. Harris explained that the vast majority of access charges – including the CCL, PICC, and end office switching-related charges – cannot be minimized through more efficient trunking. Only the charges for entrance facilities and direct-trunked transport (which together represent only three percent of total access charges) can be minimized.[185] The Applicants have ignored these fundamental criticisms, strongly suggesting that they have no valid response.

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[183] Harris LD Reply Affidavit at 47.

[184] *Id.* The same flaw renders the Applicants' claimed access cost savings unreliable, as Dr. Harris explained in his March 13 Long Distance affidavit. In particular, the Applicants should have examined the access charge savings (that is, the avoided access charge less the company's internal cost of providing access) resulting from *additional* MCI traffic routed over WorldCom's access facilities *as a result of the merger.* Harris LD Affidavit at 42.

[185] *See* Harris LD Affidavit at 42.

3. To the extent cost savings exist, they almost certainly result from reduced investment and increased profits due to less competition.

There is strong reason to believe that the cost savings cited by WorldCom and MCI will result directly from reduced investment and decreased competition. As GTE and others pointed out in their Comments,[186] Wall Street analysts have concluded that the merger will produce efficiencies and synergies through a "significant cut back in the aggressive local market entry plans at MCI/Metro which are now redundant to existing and planned MFDS and Brooks CLEC assets."[187] These same analysts also predict that savings will accrue to the companies because both local and long distance pricing will feel less pressure following the merger.[188]

Moreover, to the extent the Applicants claim they will be able to achieve cost savings by consolidating their long distance networks, such claims are inconsistent with their assertions that there are no barriers to entry in long distance markets. As Dr. Harris explains, "[t]he fact that companies as large as MCI and WorldCom believe that

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[186] *See, e.g.,* Reply Comments of Communications Workers of America, CC Docket No. 97-211 (filed Mar. 20, 1998) at 6-8; GTE Comments at 98.

[187] GTE Comments at 98, *citing* Merrill Lynch In-depth Report, "United States Telecommunications/Services" at 2, Feb. 4, 1998 ("Merrill Lynch"). Additional support for the financial analysts' position is found in the conclusions of the Communications Workers of America, who noted that "the only logical explanation for the reduction of $5.3 billion in expenses in the local market is that the merged entity will shift focus from MCI's pre-merger plans to compete in the residential and small business markets to WorldCom's exclusive focus on large and medium-sized business customers." Reply Comments of the Communications Workers of America, CC Docket No. 97-211, at 14 (filed Jan. 26, 1998).

[188] GTE Comments at 98, *citing* Merrill Lynch at 2.

they have not reached minimum efficient scale (*i.e.*, that they are still on the downward sloping portion of the average cost curve) provides compelling evidence that the massive capital costs and sunk investments required to compete in the long-distance market are a substantial barrier to entry."[189]

The Applicants cannot have it both ways. If they truly expect to achieve cost savings of the magnitude claimed, then they must acknowledge that new entry will be insufficient to outweigh the grave competitive concerns posed by the merger. On the other hand, if they are correct that there are no barriers to entry, then there is no way they could achieve any significant cost savings, and thus no basis for asserting that the public interest benefits of the merger exceed the tremendous increase in concentration in key markets. In either event, the Applicants will have failed to carry their burden under *Bell Atlantic/NYNEX*.

* * *

For the third time, the Applicants have failed to demonstrate that the proposed merger will result in pro-competitive benefits that outweigh any competitive harms. They have intentionally ignored the *Bell Atlantic/NYNEX* requirement that their efficiency claims be stated with specificity, in a verifiable manner, and with an explanation why they would not arise "but for" the merger. As a result, there is serious doubt that their claimed cost savings and synergies will truly materialize. In fact, it appears that any efficiencies arising from this merger will likely result from cutbacks in investments in local service and reduced competition. Such a result is clearly not in the

[189] Harris LD Reply Affidavit at 51.

public interest. Accordingly, the Commission should dismiss, or in the alternative, deny their applications.

VI. CONCLUSION

WorldCom and MCI apparently view the Commission's merger review process as a war of attrition. Three times – in their applications, their Joint Reply, and their Second Joint Reply – they have been given the opportunity to demonstrate that their proposed merger would serve the public interest. Each time, they have declined to provide data to support their claims, challenged the applicability of the *Bell Atlantic/NYNEX* analytical framework, ignored plainly controlling FCC precedent governing market definitions and identification of most significant competitors, and sought to shift the burden of proof to opponents of the merger. And, in each of their Joint Replies, they have either overlooked or belittled detailed and compelling showings by GTE and other parties that the merger would have profoundly anticompetitive and anti-consumer consequences across a range of vitally important markets.

These tactics should not be tolerated. The statutory public interest standard contained in Sections 214 and 310 applies equally to all companies under the Commission's jurisdiction. Similarly, the *Bell Atlantic/NYNEX* framework governs all horizontal mergers involving potentially significant degrees of market overlap, not just mergers involving "dominant" carriers. Even if WorldCom and MCI legitimately believed when they filed their applications that they could treat the then-largest telecommunications merger in history as a run-of-the-mill transaction that could be approved based on promises and platitudes, they have since been given ample opportunity to correct their error in judgment. Their repeated failure to do so necessitates dismissal or denial of their applications.

Respectfully submitted,

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APPENDIX 1

BEFORE THE FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of Applications of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.	)	CC Docket No. 97-211

Long Distance Reply Affidavit of Robert G. Harris on behalf of GTE Corporation

June 8, 1998

Before the Federal Communications Commission
CC Docket No. 97-211

Long-Distance Reply Affidavit of Robert G. Harris

Table of Contents

I. Introduction and Summary of Arguments

A. Introduction

1. My name is Robert G. Harris. I am a Principal with the Law and Economics Consulting Group (LECG) and Professor Emeritus of Business and Public Policy at the Haas School of Business, University of California, Berkeley. My business address is 2000 Powell Street, Suite 600, Emeryville, CA 94608.

2. On March 13, 1998, I submitted two affidavits before this Commission which examined the likely impacts of the proposed merger between MCI Telecommunications Corporation ("MCI") and WorldCom, Inc. ("WorldCom"). My two prior affidavits separately analyzed the potentially harmful effects of this merger on long-distance markets and Internet markets. Since that time, experts for MCI and WorldCom have put forth additional claims on the merits of their merger, and I have developed additional information on numerous aspects of the proposed merger. Therefore, I have been asked by counsel for GTE Corporation and its affiliated companies ("GTE") to re-examine this merger in light of both this new evidence and MCI-WorldCom's analysis of their proposed transaction.

B. Summary

3. I have applied the framework developed by this Commission in its Bell Atlantic Nynex decision, where:

> "[the] examination of a proposed merger under the public interest standard includes consideration of the competition policies underlying the Sherman and Clayton Acts. ... In order to find that a merger is in the public interest, we must, for example, be convinced that it will enhance competition. ... If applicants cannot carry this burden, the applications must be denied. ... [It] is incumbent upon applicants to prove that, on balance, the merger will enhance and promote, rather than eliminate or retard, competition"[1]

[1] See *In the Applications of NYNEX Corporation Transferor and Bell Atlantic Corporation Transferee, For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries*, Memorandum Opinion and Order, File No. NSD-L-96-10, August 14, 1997, at ¶¶ 2-3.

4. This Commission correctly placed the focus on "enhancing competition." I note that the standard in this case is very different from that which this Commission applies when reviewing Bell Operating Companies' applications for in-region interLATA authority, in which case the relevant question is whether the market for local service is open to competition. The question before the Commission in this case is "what effect will this merger have on consumers", not whether or not competition has increased recently in the supply of long-distance services. While long-distance competition has increased over the last few years, mostly as a result of WorldCom's growth and focus as a wholesaler, the overall performance indicates that the industry is not yet fully competitive. The merger will greatly reduce competition in one fell swoop. While competition may continue to grow after the merger, it will do so from a greatly reduced base, and likely at a much slower rate than what would occur had the merger not been consummated. Thus, consumers will be harmed substantially and over a significant period of time.

5. Specifically, the merger of the second- and fourth-largest facilities-based carriers will have a profound effect on residential, small business and wholesale long-distance customers. By eliminating the most aggressive wholesale supplier, costs to resellers (the main source of competition for residential and small business customers) will be higher than they would have been otherwise, reducing resellers' ability to compete with the Big Three carriers. Consumer welfare will therefore be harmed by the proposed transaction. While competition will continue to develop even if this merger were approved, the critical point is that competition would be greater and develop faster if WorldCom were to remain an independent entity. The merger will therefore eliminate and retard competition, and should therefore be denied.

6. MCI-WorldCom's experts have depicted the long-distance services industry as a competitive market where they claim entry is likely, timely, and sufficient, as defined by the Federal Trade Commission's and U.S. Department of Justice's *Horizontal Merger Guidelines*. By way of support, they list the investment plans and financial press releases of these entrants and remark that these investment plans add up to many billions of dollars. They claim this "massive" entry is proof both that the market is competitive and that it will remain so after the proposed merger.

7. The simplistic explanation put forth by MCI-WorldCom's experts is wrong and misleading because it is based on nothing more than a cursory evaluation of the industry. First, the entry they cite is quite small relative to the industry as a whole. Second, these attempts to enter the long-distance industry suggest that incumbents are earning supracompetitive profits. (I show that the alternative explanations that entrants have better technology or that entry is responding to the increased demand from the Internet are not supported by the facts.) Third, the entry that the MCI-WorldCom economists are relying upon is, in reality, taking substantially longer than planned. For example, Qwest is behind schedule on approximately 40% of its planned network. Finally, the merger applicants' experts ignore the competitive dynamics of the long-distance industry which relegate fringe facilities-based firms to a marginal role as far as their influence on price is concerned. They also ignore the substantial transaction costs of cobbling together a network from many small independent facilities-based vendors.

8. While the growth of resellers (largely as a result of WorldCom's emergence as a wholesale supplier) has contributed to increased competition at the retail level, concentration remains high and has developed slowly at the facilities-based level. Combined with the pervasive economies of scale, scope, and density in this industry, these transaction costs ensure that incumbents will only be constrained in their pricing by firms of similar size. WorldCom has just recently reached the size of the three historic incumbents, and in some aspects it has achieved the number two position. Therefore, the small fish who are entering now cannot replace as a competitive force the large fish that is being removed from the industry. Nor are these small fish capable of becoming effective competitors in a time frame suitable for antitrust analysis.[2]

9. In assessing the impact of this merger on long-distance markets and replying to the opinions put forth by MCI-WorldCom and their economic experts, there are a number of key issues I would highlight:

(a) There are separate relevant product markets for wholesale long-distance network services and retail long distance service.

(b) The appropriate geographic scope for the wholesale network services market is national.

(c) Point-to-point transport is an input into the supply of wholesale network services.

(d) Competition in concentrated areas has little impact on prices in areas without competition, as is demonstrated by regionalized transport capacity shortages and higher prices in areas with fewer competitors.

(e) End-user prices for long-distance services are substantially above cost. New entry, and the lofty valuations placed on new entrants, are a response to the prospect of earning excess profits.

(f) The additional competition that new entrants may provide as a result of this merger will not be sufficient to replace the competitive force that will be lost through the elimination of WorldCom as a separate entity. The analysis of entrants presented by MCI-WorldCom is seriously flawed.

(g) WorldCom's incentives will change after the merger. It will no longer have an incentive to be a maverick carrier. Wholesale prices to resellers will rise, and wholesale quality will diminish, resulting in end-user prices that will be higher after this merger than they would have been otherwise.

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[2] As I have shown in Exhibit 16 of my prior long-distance affidavit, even the largest fringe competitor would need to grow 40% faster than Sprint Corp. to catch up with Sprint by 2003.

(h) MCI and WorldCom have overstated the efficiencies that may arise from the merger. Cost savings appear to be exaggerated, and the Applicants do not address the substantial costs of integrating disparate networks using different technologies, billing systems, and operations support systems.

(i) Efficiencies which may be created by the merger are outweighed by its anticompetitive effects. To the extent they exist, the merger's efficiencies are additional evidence of barriers to entry in long-distance markets through economies of network scale, scope, and density.

II. Market Definition

A. Separate wholesale and retail product markets

10. MCI-WorldCom's economists, Drs. Dennis W. Carlton and Hal S. Sider, fail to define the market for long-distance services correctly, claiming that there is no product market distinction between wholesale and retail services,[3] which is roughly equivalent to arguing that automobile manufacturing and automobile retailing are not separate relevant markets. In contrast, MCI-WorldCom's other expert, Professor Hall, does distinguish between wholesale and retail markets.[4] I believe that Carlton and Sider's analysis is incorrect, and that in fact there are two distinct, yet "vertically-related" product markets that need to be considered:

- wholesale supply of long-distance network services
- retailing of long-distance service

11. My determination of relevant markets uses the same approach applied by this Commission in *LEC In-Region Interexchange Order*[5] and reiterated in the *Bell Atlantic Nynex* Order:

> "the Commission defined a product market as a service or group of services for which there are no close demand substitutes. ... In the LEC In-Region Interexchange Order, we further observed that for purposes of analysis we could aggregate separate products markets for which customers faced the same competitive alternatives."[6]

[3] *Second Joint Reply of WorldCom, Inc. and MCI Communications Corporation,* In the Matter of Applications of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc., CC Docket No. 97-211, Before the Federal Communications Commission, March 20, 1998, pp. 23-29.

[4] See *Declaration of Robert E. Hall,* attached to the Applications of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc., CC Docket No. 97-211.

[5] Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, Second Report & Order, CC Dkt. No. 96-61, FCC 97-142, 1997 WL 193831 (rel. April 18, 1997) ("LEC In-Region Interexchange Order").

[6] See *Bell Atlantic Nynex* MO&O, *op. cit.*, at ¶ 50.

12. I use the term "network service" to describe the type of functionality demanded by end-users, who typically wish to make calls to and receive calls from many other users of the network, who may be distributed over a wide geographical area. Network services are therefore fundamentally different from point-to-point transport services, which are quite simply the bulk transmission of bits of information between two distant points. Point-to-point transport, or just "transport", is one of the fundamental inputs into the supply of long-distance network services. Transport is sold in large blocks of capacity, denoted by the maximum transmission speed (alternatively known as bandwidth) available over the link, just as crude oil is sold by the tanker load (*i.e.* thousands of barrels). The most common long-distance transport denomination is currently Digital Service 3 (DS-3), although transport providers commonly offer transport capacities ranging from Digital Service 0 (DS-0, 1/672 of DS-3) to Optical Carrier 48 (OC-48, 48 times DS-3). At the transport level, there is no distinction as to the type of end-user service being offered: it could be either voice, data or multimedia service – all traffic travels as data on the transport network.

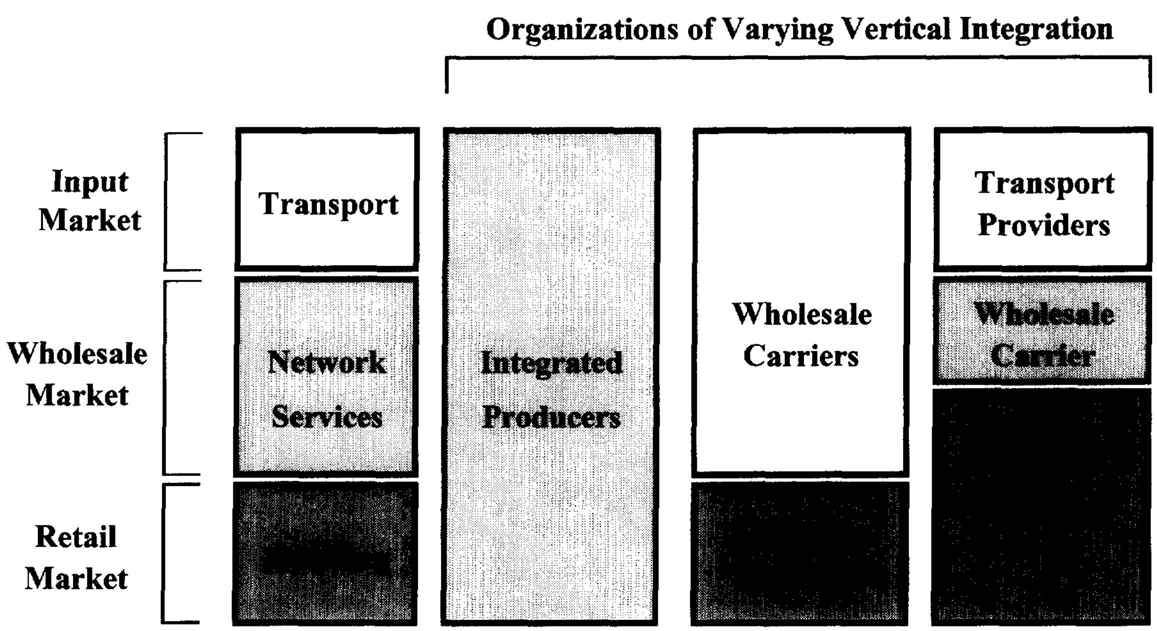
13. Wholesale suppliers of long-distance network services combine transport links with complex hardware and software systems to provide the services which an end-user can consume. In the case of traditional long-distance, the long-distance provider combines transport with voice switches and billing systems and a host of other services as I explained in more detail in my original affidavit. Transport is therefore an input into the supply of long-distance network services, and over time independent suppliers of transport have emerged. There are substantial vertical efficiencies, however, in combining the provision of long-distance network services with the provision of transport services. As I show below, vertical integration greatly reduces transaction costs and improves the carrier's control over network quality.

14. Retailers of long-distance network services package one or more network services together and sell them to end-users. These retailers do not necessarily "produce" the service, *per se*; they package quality, pricing and a diversity of features for end-users.

15. These two separate wholesale and retail markets, as well as the input market (transport) are easily confused because the supply of long-distance services has been traditionally characterized by a high degree of vertical integration between the suppliers of the input (transport), wholesale suppliers of the network services, and the retailing of the end-user service. For example, AT&T owns both its transport infrastructure and its long-distance voice services network, and retails directly a great proportion of its long-distance network services. As competition has evolved in long-distance services, new types of telecommunications providers have emerged. These include independent transport and wholesale service providers, such as WilTel (originally a division of the Williams Companies, now part of WorldCom), which began supplying bulk network services in 1991.

16. In addition, switchless resellers such as GTE buy long-distance network services in bulk from long-distance network wholesale suppliers such as WorldCom and then retail these services to their end-users, adding typical retail functions such as branding, marketing, advertising, billing and collections. Switched resellers own some switching equipment to provide value-added features, substituting it for some of the switching equipment of the wholesale supplier. Consequently, switched resellers typically purchase from upstream firms a mix of network services and transport services to interconnect their switches and the locations where they pick up or drop off traffic.

17. The figure below illustrates the interplay of various types of firms which combine these three distinct activities in the production of long-distance communication services. For example, the second column below adequately represents MCI's operation - comparatively little of its revenues derives from sales to other than end-users, and it purchases relatively little from other long-distance suppliers. The third column represents WorldCom's operation, which relies much more heavily on bulk sales to resellers. The fourth column represents a typical new entrant, such as Frontier, who is heavily dependent on purchases of transport capacity from other providers, and also sells large amounts of bulk network service to resellers, which sometimes have their own switches to add value to their services.



18. Distinguishing these markets is important, as this transaction will tend to have a disproportionate impact on some of them. In particular, these product markets vary in their competitiveness. Additionally, the wholesale supply of long-distance network services and its retailing have very different cost margins, which I discuss in detail later in this affidavit.

B. Geographic markets

1. Geographic scope differs between wholesale and retail markets

19. Drs. Carlton and Sider also incorrectly assert that the geographic market for long-distance services is a national one.[7] Carlton and Sider are confusing the geographic scope of different wholesale and retail markets. Retail long-distance services have a national and international dimension in the sense that retail subscribers expect to be able to call other subscribers around the country and the world. However, long-distance service offered in California is not an effective substitute for a consumer who lives in Montana.[8]

20. Thus an appropriate geographic market for retail long-distance service would be a relatively small area, such as a LATA, because all customers within a LATA generally face the same retail long-distance market conditions. Most customers choose a single interexchange provider regardless of where their calls terminate. Although retail long distance is a national (and international) service, it can be sold locally. In this sense, long distance service is truly unique: customers purchase a *national (*or *international)* service, but they generally use it only in one place: their *home* market. In order to originate a long-distance call, a carrier must have a point-of-presence (POP) in the LATA where its customer resides, or it must lease transport or wholesale service from another long-distance carrier who has a presence in the LATA. A POP is the physical location within a LATA where a long-distance carrier interfaces with the network of the local exchange carrier.

21. Wholesale network service is bought by resellers (and by large industrial customers on wholesale terms) on a national basis - for example, GTE selected WorldCom as its nationwide supplier of wholesale 1+ and 800 switched service. As I explain in detail in a later section, the high transactions costs that would result from a reseller attempting to integrate network services from two wholesale vendors make such attempts uneconomic. Therefore, the geographic scope of the market for wholesale network services is national.

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[7] *Supra* 3.

[8] Although the same rate plan which aggressively promoted in California may be technically available in Montana, a carrier may entirely legally choose not to promote it in Montana, nor actively inform Montana residents of that plan's existence. In extreme cases, a carrier may even choose to be not certified in a particular state.